COMMONWEALTH OF MASSACHUSETTS

DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Investigation by the Department on its own Motion into the Appropriate Regulatory Plan to succeed Price Cap Regulation for Verizon New England Inc. d/b/a Verizon Massachusetts' intrastate retail telecommunications services in the Commonwealth of Massachusetts	)	D.T.E. 01-31 Phase II (Track B)

REPLY BRIEF OF VERIZON MASSACHUSETTS

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The Department's goal for the telecommunications industry for the past 15 years "has been to evolve regulatory requirements and oversight to match the evolution of market forces." *Phase I Order*, at iv. Based on extensive record evidence concerning wide-spread competition in all telecommunications markets in Massachusetts, the Department's *Phase I Order* properly continued this evolution by recognizing that the operation of market forces is the best means to achieve economic efficiency, technological innovations, a greater sensitivity to customer demands, and just and reasonable prices. As Verizon Massachusetts ("Verizon MA") demonstrated through its testimony and in its Initial Brief, the Verizon MA Alternative Regulation Plan ("Plan") furthers these objectives and should be adopted by the Department.

In this Reply Brief, Verizon MA responds to the Attorney General's objections, as well as the initial briefs filed by AT&T and WorldCom.[1] Only the Attorney General opposes the basic structure of the Plan. The Attorney General's objections to Verizon MA's Plan rely on outmoded embedded cost-of-service analyses in an effort to turn back the clock on competitive developments and the resulting benefits that are accruing to all Massachusetts customers. The

[1] Although Verizon MA will address many of the arguments in intervenors' initial briefs, silence on any issue should not be construed as agreement with any statement made by another party.

Department cannot, however, retreat from today's reality as the Attorney General suggests. Massachusetts markets are irreversibly opened to competition, which is thriving and growing daily. As the Department recognized in the *Phase I Order*, a regulatory framework that reflects this reality is necessary because competitive market controls – rather than government regulation – have long been the Department's goal and remain in the best interests of consumers.

As the record here amply demonstrates, Verizon MA's Plan confirms the Department's tentative conclusions regarding the appropriate form of regulation for Residence services. The record shows that providing Verizon MA with the flexibility to increase rates for Residence Basic services by a modest 5 percent annually furthers the Department's goal of more market-based and efficient pricing, while at the same time promoting the Department's ratemaking goal of continuity and the preservation of universal service. Residence Basic service prices are currently well below efficient competitive levels, and such prices can slow the pace of competitive entry to the long-term detriment of consumers in Massachusetts. In short, the Department should approve Verizon MA's Plan because it will result in just and reasonable rates, consistent with competitive pricing principles and traditional ratemaking goals applied by the Department.

I. VERIZON MA'S RESIDENCE DIAL TONE LINE RATE PROPOSAL IS REASONABLE

In the *Phase I Order*, the Department directed Verizon MA to lower its intrastate switched access charges to "the more cost-based interstate levels." *Phase I Order*, at 63. The Department recognized that the corresponding reduction in intrastate switched access revenues "must be made up by increasing residence dial tone rates." *Id.* In compliance with the Department's *Phase I Order*, Verizon MA increased its Residence Dial Tone Line rate to offset

the calculated reduction in intrastate switched access revenues (Exh. VZ-2, Attachment A, Tab B, Attachment I, Workpaper 1, line 22a (revised August 28, 2002)).

The Attorney General takes issue with Verizon MA's calculations of the revenue-neutral offset. As discussed below, his contentions are without merit and should be rejected by the Department. There cannot be any question that Verizon MA has properly complied with the Department's directive in the *Phase I Order.*

A. The Dial Tone Line Rate Change Is Fair, Reasonable, and Non-Discriminatory

1. Verizon MA's Proposed Residence Dial Tone Line Rate Change Is Based on Known and Measurable Data Rather Than "Estimates"

Citing to Verizon MA's Exhibit VZ-2, Attachment A, Tab B, Attachment I, Workpaper 1, the Attorney General maintains that Verizon MA's proposal to increase the Residence Dial Tone Line rate at the outset of the Plan is based only on estimates, and that Verizon MA has not provided evidence that its lost revenue calculation is accurate (*id.*, at 11). According to the Attorney General, a better approach would be to recover only actual lost revenues and conduct an earnings review to ensure that the increases are necessary for Verizon MA to obtain reasonable compensation (*id.*). The Attorney General's argument is based on a misunderstanding of Verizon MA's case and ignores clear Department precedent.

The confusion of the Attorney General is evidenced by the fact that he cites to the very record evidence that he asserts has not been provided. Exhibit VZ-2, Attachment A, Tab B, Attachments I through V provide a detailed calculation, including references to the source of the line-by-line entries, used to determine Verizon MA's proposed increase in the Residence Dial Tone Line rate. Tab B, Attachment I identifies the required revenue offset per Residence line associated with reducing Verizon MA's Switched Access rates, as well as the elimination of a

separate charge for Residence Touch Tone Service, and shows the proposed monthly revenue offset for the revenue reductions.

Contrary to the Attorney General's claim, this Attachment unequivocally demonstrates that Verizon MA relied on *historical* billing determinants to establish the required revenue offsets, and that no "estimates" of future losses were used for this purpose. The Attorney General's suggestion that it would be "fairer" for the Department to allow the Company to recover "actual" lost revenues similarly is without merit. The Department has consistently required that Verizon MA use historical data to compute the revenue effect of rate changes. *New England Telephone and Telegraph Company*, D.P.U. 89-300, at 436 (1990) ("To maintain revenue neutrality, the filing shall be based on the actual billing determinants…during the twelve-month period preceding the filing…"). Indeed, it is precisely because of the uncertainty associated with estimating future demand effects that has led to the Department's traditional reliance upon historical billing determinants when making revenue-neutral rate offsets, as is the case here. *Boston Edison Company*, D.P.U. 85-266-A/85-271-A, at 56, n.8 (1986). Neither the Attorney General nor any other party questioned through record evidence the accuracy of Verizon MA's quantification of the revenue-neutral Dial Tone Line rate change mandated by the *Phase I Order*. The Attorney General's belated effort on brief to raise an issue concerning the rate change is simply wrong.

2. The Dial Tone Line Rate Change To Offset Reduced Intrastate Access Charges Is Revenue Neutral.

The Attorney General argues that the required increase to the Dial Tone Line rate may not be revenue neutral because interexchange carriers may not pass along their switched access charge savings to customers (Attorney General Initial Brief, at 11). In support of this claim, he

cites Dr. Taylor's response contained in Exhibit DTE-VZ 1-10 (Phase I). The Attorney General's claims completely miss the mark.

First, the Attorney General erroneously states that determining whether Verizon MA's switched access rate changes are revenue neutral depends on the impact of those changes to the interexchange carriers' retail toll customers. This is a novel theory, unsupported by any Department precedent, or evidence in this proceeding. The Department has consistently rebalanced rates on a revenue-neutral basis by gauging the effect on Verizon MA – not end user customers. *See New England Telephone and Telegraph Company*, D.P.U. 94-50, at 38 (1995). Thus, Verizon MA's calculation of the revenue-neutral Dial Tone Line rate is not dependent on whether interexchange carriers reduce their retail toll rates to reflect the Department-mandated reductions in switched access charges. The actions of interexchange carriers do not alter the fact that Verizon MA's switched access revenues are directly reduced by the Department's order, and a corresponding change must, therefore, be made in other rates to maintain Verizon MA's total revenues.

Second, the Attorney General's reliance on Dr. Taylor's Phase I testimony is completely misplaced and does not support the Attorney General's proposition. In Exhibit DTE-VZ 1-10 (Phase I), Dr. Taylor noted that Verizon MA's revenue-neutral rebalancing of switched access rates and the Residence Dial Tone Line rate did not take into account any demand effects. He testified that, if interexchange carriers did not pass through the switched access reductions to their retail end users, there would be little effect on switched access demand. Dr. Taylor further explained that, if interexchange carriers did in fact reduce their retail toll prices in response to the switched access rate reductions, Verizon MA would be compelled to reduce its toll prices as well, and consequently, the total revenue effect of the switched access reduction would be

significantly higher than Verizon MA computed. Dr. Taylor estimated that considering demand effects would produce a monthly Dial Tone Line increase of about $4.00 – about twice what Verizon MA has computed. Thus, contrary to the Attorney General's suggestion, the fact that Verizon MA did not take into account toll reductions by interexchange carriers produces a lower offset to the Residence Dial Tone Line rate. Accordingly, his argument concerning the effects of reduced switched access rates is without merit and should be rejected by the Department.

3. Increases in the Residence Dial Tone Line Rate To Offset Reductions in Switched Access and Collocation Rates Is Just and Reasonable and Nondiscriminatory.

The Attorney General claims that Verizon MA's proposal to recover lost revenues from switched access rate reductions (and collocation rate changes)[2] is unfair and discriminatory because only Residence customers are being asked to make up the revenue shortfall (Attorney General Initial Brief, at 12). Notably, the Attorney General's expert, Dr. Gabel, agreed with Verizon MA that such lost revenues should be recovered from customers based on Ramsey pricing principles (*i.e.*, responsibility for cost recovery should be placed on those services having the lowest elasticities of demand) (*see* Exh. AG-1, at 13-14). However, the Attorney General's allegation that it is unfair for Residence rates to be raised to account for this rate-rebalancing is based on the erroneous premise that the Residence Dial Tone Line is no longer the most inelastic service. As described in Verizon MA's Initial Brief, that contention is without merit.

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[2] Although the Attorney General accurately describes Verizon MA's proposal as an increase of $1.97 per month for residence customers with Touch Tone Service (and $2.44 for customers without Touch Tone Service) (Attorney General Initial Brief, at 10), he also implies that Verizon MA's proposal could lead to an increase of $7.00 per month (*id*., at 10-11). This is a misleading statement since the larger increase would happen only if the Department ordered rate reductions *not* proposed by Verizon MA. As described by Ms. Brown, Verizon MA's Plan, if approved as filed, would require the much more modest adjustments to the Residence Dial Tone Line rate (Exh. VZ-5, Attachment A, Tab B, Attachment I, Workpaper I (revised August 28, 2002)).

The Department has repeatedly determined that "[i]n competitive markets for telecommunications services, efficient market prices are based on incremental cost plus a mark-up for joint and common costs, based on Ramsey pricing principles" (Verizon MA Initial Brief, at 8, *citing Phase I Order*, at 101). There was no debate among the expert economists, including the Attorney General's expert, Dr. Gabel, that economically efficient pricing, under Ramsey pricing principles, would produce rates that place greater responsibility for cost recovery on services having the lowest elasticities of demand (Verizon MA Initial Brief, at 10):

> More economically efficient price levels are achieved when rates for more elastic services (toll and auxiliary offerings) are moved closer to costs and rates for more inelastic services (Dial Tone Line charges) are residually priced.

Exh. VZ-2, at 13. Moreover, Verizon MA presented unrebutted evidence in this case demonstrating that the Residence Dial Tone Line rate is far below an economically efficient level because it fails, by a significant margin, to provide a comparable level of contribution toward the recovery of Verizon MA's joint and common costs as other services (*see* Verizon MA Initial Brief, at 9).

The difference of opinion focused only on whether the Residence Dial Tone Line is the *most* inelastic service (Verizon MA Initial Brief, at 10). Dr. Taylor and Dr. Mayo testified that the demand for residence customer access (dial tone) is highly inelastic both in an absolute sense and relative to other telecommunications services. The Attorney General's position is based on the assumption that the current competitive telecommunications market has significantly changed the measure of *relative* elasticities (*i.e.*, it is no longer the most inelastic) for Residence Basic service compared with other services offered by Verizon MA. This assumption is erroneous.

The Attorney General observed that recent competitive entry by wireless carriers, competitive wireline carriers and cable companies now provides a variety of substitutes for Verizon MA's Dial Tone Line service, potentially increasing the elasticity of Verizon MA's Dial Tone Line service (Exh. VZ-3, at 22). However, the Attorney General fails to consider that many of the same alternative services (*i.e.*, wireless and cable telephony) also provide substitute alternatives for *other* services provided by Verizon MA. Even assuming some change in the elasticities for the Dial Tone Line and other services, there would have to be a complete reversal of *relative* elasticities with the Dial Tone Line to justify the recovery of the lost revenues from a service other than residence customer access (*i.e.*, Dial Tone). Dr. Taylor testified that such an assumption is not only incorrect, but irrelevant (*see* Verizon MA Initial Brief, at 11).

The Attorney General's claim that it is "discriminatory" for residence customers to be responsible for all of the lost revenues similarly is without merit (Attorney General Initial Brief, at 12). It is "axiomatic in ratemaking that different treatment for different classes of customers, reasonably classified is not unlawful discrimination." *American Hoechest Corporation v. Department of Public Utilities*, 379 Mass. 408, at 411 (1979), *citing Boston Real Estate Board v. Department of Public Utilities*, 334 Mass. 447, 495 (1956). "The question is whether the rate is unduly or irrationally discriminatory." *Id*., *citing* J. Bonbright, *Principles of Public Utility Rates*, 369-385 (1961):

> [W]e repeat again the principle that when alternative methods are available, the [D]epartment is free to select or reject a particular method as long as its choice does not have a confiscatory effect or is not otherwise illegal.

American Hoechest Corporation v. Department of Public Utilities, at 413, *citing Massachusetts Electric Company v. Department of Public Utilities*, 376 Mass. 294, 302 (1978).

In this case, the proposed recovery of lost revenues from Residence customers is reasonable and is neither unduly nor irrationally discriminatory. The Department has affirmed that efficient market prices will be its benchmark in determining whether regulated prices are just and reasonable:

> [W]e can look to principles of competitive pricing for standards to judge whether regulated prices for specific services are just and reasonable. In competitive markets for telephone services, efficient market prices are based on incremental cost plus a mark-up for joint and common costs, based on Ramsey pricing principles.

Phase I Order, at 101. Verizon MA's Plan to recover its lost revenues from Residence customers relies on the principle of efficient pricing (*see* Verizon MA Initial Brief, at 22-24).

The Attorney General also argues that the Department should not allow revenue-neutral adjustments to the Residence Dial Tone Line rate because such adjustments are associated with rate-of-return regulation, which the Department has not required in this case (Attorney General Initial Brief, at 12). The Attorney General's position is a red-herring because the recovery of reduced switched access revenues through increases in the Residence Dial Tone Line charge is not a new feature of the Plan under review, but rather reflects only a continuation of the Department's rate-rebalancing process initiated in D.P.U. 89-300 (1990).

In *New England Telephone and Telegraph Company*, D.P.U. 89-300 (1990), the Department began a series of annual, revenue-neutral "rate re-balancings" to bring Verizon MA's retail rates more in line with the underlying cost structure. *Phase I Order*, at 21 (citations omitted). Consistent with the Department's determination that competition would benefit by moving prices toward more economic rate levels, usage charges (local, toll and access) were lowered substantially, while Dial Tone Line rates were increasing. To minimize customer

impacts as rates were adjusted, the Department determined that rate changes should occur gradually through a series of annual transition filings (Exh. VZ-2, at 4).

The Department further advanced its rate rebalancing efforts in the *Phase I Order*, when it required that Verizon MA reduce its switch access charges to interstate levels noting that this was consistent with its past rate re-balancing process. *Phase I Order,* at 62-63. Furthering the objective of rate rebalancing is consistent with the Department's principle of looking to competitive pricing to judge whether regulated rates for specific services are just and reasonable. *See id.*, at 100-101. Accordingly, the Attorney General's criticism should be rejected by the Department.

4. The Attorney General Erroneously Contends That the Local Loop Is a Shared Facility and Its Cost Should Be Allocated Among Other Services.

The Attorney General argues that the recovery of loop costs through a flat Dial Tone Line rate sends an incorrect price signal to customers because the loop is becoming more traffic sensitive and shared among multiple end-users who are using the loop to obtain various communication services (Attorney General Initial Brief, at 12). As explained in detail in Verizon MA's Initial Brief, the Attorney General's contention that the loop is a shared facility is without merit. Indeed, the notion that the cost of the loop should be allocated across different services is widely rejected by economists because it conflicts with the fundamental principle of cost causation (Verizon MA Initial Brief, at 26-29).

The Department has consistently held that the principle of cost-causation should guide economically efficient pricing of the loop. Dr. Taylor testified that only a price reflecting the full economic cost of the loop ensures the socially optimal level of use of that facility (Exh. VZ-6, at 13). He explained that rather than improperly equating shared cost with shared use, the correct economic principle treats a loop facility as a provider of connectivity to the network, which is a

service in its own right with its own unique cost and price (*id.*, at 10). Once a customer acquires network connectivity (a loop), other services can be made available to that customer only at *additional* cost. For example, provision of toll service to a customer would cause the network to incur a cost that is separate from that for the loop. Therefore, the loop cannot be a joint or shared cost (*id.*, at 11).

The Attorney General suggests that the loop costs are traffic sensitive by alleging, without reference to any Department order, that the Department "has determined that such equipment is engineered based upon busy hour usage" (Attorney General Initial Brief, at 12). In fact, the engineering design is irrelevant to how an individual customer causes the cost of a loop to be incurred.

The Attorney General has previously argued before the Department that the loop should be a shared cost, and that some of the costs of competitive products have been incorrectly transferred to the cost of the access function of the loop. *See New England Telephone and Telegraph Company*, D.P.U. 86-33-G, at 458-460 (1989). The Department clearly rejected that charge, and found that "[t]he access function is essentially customer-related, as contrasted with the central-office switching and transport functions, which we have classified as related to traffic-sensitive need." *Id.*, at 455. The Department also found that:

> Access is customer-related because it is the demand for lines connecting the customer's premises with the central office that causes these costs to be incurred. The plant functionalized as access consists of the loop plant and the portion of the equipment in the central office associated with terminating the loop at the switch.

Id. The Department concluded that because the cost of the loop is incurred on a per-customer basis, an appropriate way to charge for these costs is on a per-customer basis:

> This could be done through a flat customer charge calculated simply by dividing the allocated cost of access by the number of customer lines. Thus, the step of estimating the marginal cost of access would be extraneous, since the ultimate calculation of the per-customer, access-related charge would be derived by dividing the allocated cost of access by the number of customer lines.

Id., at 464. Accordingly, the Attorney General's arguments that a portion of loop costs should be allocated to other services and are traffic sensitive are without merit and should be rejected by the Department here, as similar arguments have been rejected in past cases.

B. Verizon MA's Inclusion of Touch Tone Service in the Dial Tone Rate Is Reasonable.

The Attorney General objects to Verizon MA's compliance with the Department's directive in the *Phase I Order* to eliminate the separate Touch Tone charge and add it to the Dial-Tone line rate (Attorney General Initial Brief, at 13-14). According to the Attorney General, Verizon MA's proposal would be discriminatory because it favors Touch Tone customers over customers using rotary phones (*id*.). The Attorney General's objection is without merit.

In *Phase I*, the Department agreed with Verizon MA's proposal to eliminate the separate Touch Tone charge because the service had become a part of basic service to the vast majority (over 90 percent) of the Company's customers. *Phase I Order*, at 105, n. 66. Moreover, the Company's proposal is fully consistent with longstanding Department precedent regarding the elimination of a separate charge for Touch Tone service. More than a decade ago, the Department considered the circumstances in which the elimination of the separate Touch Tone charge would be appropriate:

> To the extent that subscription to a service like touch tone (or any other supplemental service) becomes so widespread as to be considered basic service to most customers . . . [i]t may be appropriate to eliminate the separate charge altogether and make the service part of basic exchange service.

New England Telephone and Telegraph Company, D.P.U. 89-300, at 146-147 (1990). Indeed, the Department allowed Verizon MA to eliminate Touch Tone charges for business customers in *Verizon Massachusetts*, D.T.E. 99-102, at 12-18 (2000).

Based on the uncontested evidence presented in Phase I, the Department found that it is appropriate to eliminate Touch Tone's separate charge. The Department's action does not result in unduly or irrationally discriminatory rates. To the contrary, inclusion of Touch Tone costs in the basic Dial Tone Line charge is consistent with the Department's reasonable conclusion that Touch Tone service has become so widespread as to now be considered an integral element of basic service. The Attorney General presented nothing in this case that provides cause for the Department to reverse its conclusion.

II. THE DEPARTMENT'S REVIEW OF VERIZON MA'S PLAN IS CONSISTENT WITH ITS STATUTORY OBLIGATIONS UNDER GENERAL LAWS, CHAPTER 159.

A. The Department's Approval of the Plan Does Not Require a Review of Verizon MA's Earnings.

The Attorney General alleges that Verizon MA's Plan: (1) allows for a series of potential annual rate increases to Residence Basic services without further review; (2) represents a request for a "general increase" in rates subject to G.L. c. 159, § 20; and (3) may reflect an improper delegation from the Department to Verizon MA of the Department's statutory review authority and obligation to protect the public interest (Attorney General Initial Brief, at 14-18). According to the Attorney General, because Verizon MA has proposed a general increase in rates, it has the burden to prove that the proposed rate increases are necessary, that they are just and reasonable, non-discriminatory, and that they be "neither confiscatory nor exorbitant" (*id.*). The Attorney General's claims are clearly wrong.

Through the extensive record assembled by Verizon MA in this proceeding, Verizon MA has more than fulfilled its statutory obligation in this case to demonstrate that its proposed Plan will result in rates that are just and reasonable and non-discriminatory. Nothing further is either necessary or otherwise required by the applicable statutes. The intensely competitive market for telecommunications services, together with the 5 percent cap on Residence Dial Tone Line rate increases, will provide substantial "discipline" on Verizon MA's rates and earnings as a result of the Plan. Contrary to the Attorney General's contention, there is no requirement under Massachusetts law to conduct an earnings review as part of either the initial approval or implementation of a Department-approved rate plan.[3]

The Department's jurisdiction for regulating intrastate telecommunications common carriers is provided under General Laws, Chapter 159. Sections 14 and 20 of General Laws, Chapter 159 grant the Department authority over the rates of common carriers and the responsibility for ensuring "just and reasonable" rates. *Phase I Order*, at 18. Section 14 also requires that rates not be unjustly discriminatory or unduly preferential. *Id*. (citations omitted). The two statutes grant broad authority to the Department to establish rates under a variety of alternative ratemaking mechanisms, provided the resulting rates are not confiscatory. *New England Telephone and Telegraph Company v. Department of Public Utilities*, 371 Mass. 67 (1976); *Boston Gas Company v. Department of Public Utilities*, 367 Mass. 92 (1975). As the Department stated in the *Phase I Order*:

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[3] The Department has previously found that "there are no explicit words in Sections 14, 17, or 20 that cap a utility's profits at a certain level, other than the language that rates must be sufficient to yield reasonable compensation." *NYNEX Price Cap Regulation*, D.P.U. 94-50, at 187 (1995). In addition, the Attorney General's concern with "exorbitant" rates is misplaced in this case, where the underlying standard for just and reasonable rates is being applied in the context of a competitive market for residence services. *See Phase I Order*, at 104 ("[T]he Department can conclude from the record in this proceeding that there is existing competition for Verizon's residence services, and that competition for these services is growing [citations omitted]").

> While the General Court specifies that rates are to be "just and reasonable" and that rates should provide a utility with "reasonable compensation" with reference to the service provided, neither of these two statutes prescribe a particular method by which the Department must fulfill its statutory mandate of setting just and reasonable rates or limit the Department to a specific regulatory scheme, such as cost of service, rate of return ratemaking, or indeed, regulation through a price cap.

Phase I Order, at 18-19, *citing NYNEX Price Cap Regulation*, D.P.U. 94-50, at 37-38, *Interlocutory Order on Motion to Dismiss of NECTA* (February 2, 1995) (containing a comprehensive evaluation of Department authority to permit alternatives to the rate of return regulation model). Accordingly, nothing in the applicable statutes (*i.e.*, G.L. c. 159, §§ 14, 20) requires that a cost of service and rate of return type analysis be used by the Department in this case.

In the *Phase I Order*, the Department correctly determined that "it is not feasible or desirable to institute cost-of-service regulation for only one set of Verizon [MA] customers [*i.e.*, basic residence services]." *Phase I Order*, at 99. Instead, the Department held that "some form of alternative regulation (*e.g.*, rate freeze, price cap, revenue cap, or some combination of these) may be appropriate for Verizon [MA]'s residence services and would not be inconsistent with precedent." *Id.*, at 100. The Department concluded that an "inflation minus productivity" price cap for Verizon MA's Residence Basic services may not be the best mechanism for regulating these rates because historical evidence has shown that residence rates are likely below their efficient levels. *Id*. Concluding from the extensive record that "there is existing competition for Verizon's residence services, and that competition for these services is growing," the Department determined that principles of competitive pricing should be used to judge whether regulated

prices for specific services are just and reasonable.[4] *Id*., at 101. Specifically, the Department found that efficient market prices in competitive markets for telephone services are based on incremental cost plus a mark-up for joint and common costs, based on Ramsey pricing principles. *Id*. It is against this standard that the Department may fulfill its statutory obligation to determine that Verizon MA's proposed Plan for Residence customers is just and reasonable.

The Attorney General maintains that where a common carrier proposes a general increase in rates, the Department must hold a public hearing and make an investigation as to the propriety of the proposed rate changes (Attorney General Initial Brief, at 15). Given the significant level of competition for telecommunications services in Massachusetts, it is far from certain that Verizon MA's Plan will lead to an *increase* in rates or overall revenues. However, even if Verizon MA's Plan and its future implementation do constitute a general increase in rates under G.L. c. 159, § 20, the Department has held that the required notice and investigation should be routine, with no need for a suspension of tariffs:

> As long as the Company complies with the pricing rules, we anticipate that the investigation of the annual filings will be routine and should be completed in the time between the issued and effective dates of the Company's proposed tariff revisions [reference to filing dates omitted]. Even for a general increase in rates, the statute permits, but does not compel, a tariff suspension for purposes of a Department investigation. *See* G.L. c. 159, §§ 19, 20.

NYNEX Price Cap Regulation, D.P.U. 94-50, at 219, n.129.[5]

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[4] The Department also determined that Verizon MA should be accorded, at a minimum, the same level of flexibility as it currently has with regard to its Residence Non-basic services. *Phase I Order*, at 104.

[5] Under the Department's similar statutory authority to review the rates of electric and gas distribution companies, the Department has allowed the implementation of performance-based ratemaking ("PBR") through the use of a PBR formula that is applied on an annual basis without further adjudication of a company's cost of service during the term of the plan. *See Boston Gas Company v. Department of Telecommunications and Energy*, 436 Mass. 233 (2002). The Department's use of PBR to set utility rates has been found by the Supreme Judicial Court to be appropriate under the Department's broad discretion to adopt a rate-setting methodology. *Id*., at 235.

Consistent with the procedure established by the Department in D.P.U. 94-50, Verizon MA anticipates it would submit its proposed price increases (or decreases) to the Department for review to determine whether the proposed Residence rates comply with the 5 percent cap and any other relevant elements of the Plan. However, as in D.P.U. 94-50, were the Department to approve the Plan in this proceeding, Verizon MA would expect that the Department's subsequent reviews would be limited to a determination of whether the proposed price changes are consistent with the provisions of the Plan, as approved.

B. The Department's Review of Verizon MA's Plan Does Not Require Complex and Unreliable Elasticity Studies.

In the *Phase I Order*, the Department found that in competitive markets for telephone services, efficient prices would be established based on recovery of incremental costs plus a mark-up for joint and common costs based on Ramsey pricing principles:

> Pursuant to Ramsey pricing principles, joint and common costs are recovered from services in inverse proportion to the demand elasticity of particular services. In this way, demand for services is as close as possible to the level of demand under pure incremental cost-based prices. *However, it is impractical for regulators to determine demand elasticity (and, thus, efficient mark-ups) for any specific service.*

Phase I Order, at 101 (emphasis added). The Attorney General argues that the Department's approach is overly simplistic (Attorney General Initial Brief, at 20). According to the Attorney General, implementing Ramsey-efficient prices "is far more complicated than such a ratemaking approach implies, requiring knowledge of cross elasticities and what would happen to complementary services if the Department were to raise dial tone rates" (*id.*). The Attorney General contends that the Department cannot determine Ramsey-efficient rates from the information available in the record (*id.*, at 21). The Attorney General's allegations are without merit.

As described above, the issue is not the precise calculation of elasticities for various services, but the determination that the Residence Dial Tone Line is more inelastic than other services. In fact, the record is replete with evidence establishing that the Residence Dial Tone Line is a highly inelastic service in both absolute terms and in relation to other telecommunications services (*see, e.g.*, Exh. VZ-6, at 21-22; Exh. VZ-2, at 8-9, Exh. ATT-2, at 10-12; Exh. DTE-VZ 4-1, Exh. AG-VZ 1-1, Exh. AG-VZ 3-1, Exh. AG-VZ 3-15). It is both unnecessary and impractical to require the preparation of more precise elasticity measurements. As described by Dr. Taylor, deferring Residence rate increases until formal elasticity studies are complete is unreasonable and would effectively preclude pricing flexibility forever (Verizon MA Initial Brief, at 12). He explained that it is practically impossible to obtain precise measurements of price elasticity in a dynamic competitive market. For example:

> to measure accurately the revenue effect of the proposed changes in Verizon MA's service prices, we would first need to know how demand for Verizon MA's services would change as their prices change and as the prices of Verizon MA's competitors' services change. These parameters, in turn, depend on market conditions (*e.g.*, the degree to which other services supplied by Verizon-MA and by competitors are substitutes or complements for the Verizon-MA services in question), and it is unlikely that economic estimates of these parameters from other times and other geographic areas will be relevant. In particular, the market demand elasticities discussed in the econometric literature were measured from data which did not include competitors' offerings, substitute services such as Voice over Internet, or complex optional calling plans. Further, these elasticities were measured at a time when toll prices were much higher than current prices, and in most models of long distance demand, the effect of price changes on demand is smaller at lower levels of price.

Exh. AG-VZ 3-20, Attachment (Exh. DTE 1-10 (Phase I)). In short, Dr. Taylor testified that "the information necessary to measure that effect [of a price change on revenue] is unavailable *in fact and in principle*" (*id.*) (emphasis added).

In the *Phase I Order*, the Department again concluded that "it is impractical for regulators to determine demand elasticity" for purposes of determining efficient mark-ups for any specific service. *Phase I Order*, at 101. The Department's application of an alternative regulatory approach in this case requires no change to the Department's policy or precedent.

C. The Historical Rate of Inflation Is Not the Basis For Verizon MA's Residence Basic Rate Cap of 5 Percent.

The Attorney General argues that the record contains no evidence that tracking general inflation would yield just and reasonable residence rates (Attorney General Initial Brief, at 23). According to the Attorney General, even if tracking inflation were a reasonable method for setting Verizon MA's residence rates, 5 percent exceeds reasonable estimates of inflation (*id.*). The Attorney General misconceives the 5 percent cap as a proxy for a cost-based ratemaking determination. The Attorney General is off-the-mark.

In the *Phase I Order*, the Department was clear that because historical evidence has shown that Residence rates are likely below their efficient levels, an "inflation minus productivity" price cap for Verizon MA's basic residence services would not be the best mechanism for regulating residence basic rates. *Phase I Order*, at 100. Moreover, the Department concluded that an "inflation minus productivity" price cap is inherently designed to control only the *aggregate* prices and earnings of a regulated company, rather than to calculate just and reasonable prices for any particular rate element (*id.*, at 100-101). For these reasons (and given the competitive environment for Residence services), the Department stated that a different regulatory mechanism that relied upon principles of competitive pricing to determine just and reasonable rates was appropriate. *Id.*, at 101. The Department tentatively concluded that any price increases for Residence services should be limited to 5 percent per year "[i]n order to promote our *ratemaking goal of continuity*" – not because it reflected a Department

determination that 5 percent reflected the amount by which Residence basic rates were below a traditional cost-of-service threshold.

As explained in Verizon MA's Initial Brief, the evidence Verizon MA presented about the magnitude of price increases in the Residence Dial Tone Line rate necessary to reach an economically efficient level clearly justifies more than a 5 percent annual increase in Residence Basic service prices (Verizon MA Initial Brief, at 8-14). In addition, as Ms. Brown demonstrated, that level of annual potential increase is well below the percentage increases approved by the Department in the rate-rebalancing process started with D.P.U. 89-300 (Exh. VZ-2, at 10).

The 5 percent cap provides a reasonable rate continuity constraint on Residence basic service that is roughly comparable to the historical annual change in the Consumer Price Index so that basic Residence prices at least keep pace with the long-term trends in national inflation.[6] The Plan, therefore, moves toward the Department's goal of efficient pricing in a moderate and reasonable manner, and the Attorney General's arguments should be rejected.

D. Verizon MA's Plan Neither Assumes That Residence Services Are Subsidized Nor Is It Dependent Upon There Being Any Such Subsidy.

The Attorney General claims that Verizon MA's current residence retail rates are above their current embedded costs (Attorney General Initial Brief, at 24). According to the Attorney General, Verizon MA's proposed increases would, therefore, be inefficient because the price

[6] The Attorney General's objection that Verizon MA has set no specific time table for its Plan is without merit. The Plan will continue to remain under Department jurisdiction and can be reviewed or revised as necessary. The Department has noted its intention to monitor changes in the market and make appropriate changes if circumstances warrant. *Phase I Order*, at 95.

"already exceeds 100 percent of the shared cost of the loop" (*id.*, at 25). The Attorney General's continued reliance on an embedded cost analysis in this case, however, is not relevant for setting the rates for individual services in a competitive market. To the contrary, the Attorney General's reliance on embedded costs is at odds with the Department's policy for ensuring that prices are not anticompetitive. The Department has already affirmed:

> we can look to principles of competitive pricing for standards to judge whether regulated prices for specific services are just and reasonable. In competitive markets for telephone services, efficient market prices are based on incremental cost plus a mark-up for joint and common costs, based on Ramsey pricing principles.

Phase I Order, at 101. One of the Department's goals for this proceeding is to determine how Residence prices should be set to reflect a more competitive market. *Phase I Order*, at 101. In markets such as this one, which are characterized by significant levels of competition, the forces of demand and supply will determine the *efficient* level of price (Exh. VZ-6, at 27). There is no need – either on policy or legal grounds – to judge the reasonableness of prices for individual services in such markets with any reference to allocated, embedded costs, as suggested by the Attorney General. Accordingly, the Department should reject the Attorney General's attempt to superimpose embedded cost analyses for individual telephone services in a competitive market.

E. Verizon MA's Plan Will Not Adversely Affect Universal Service.

In its Initial Brief, Verizon MA provided compelling empirical data to establish that neither the new Residence Dial Tone Line rate set as a result of revenue-neutral reductions in other rates nor the potential for a 5 percent annual increase will have any impact on universal service (Verizon MA Initial Brief, at 16-18). The Attorney General cites various national statistics, which, he asserts, should cause concern (Attorney General Initial Brief, at 28-29). The Attorney General's "statistics" prove nothing.

Despite significant Dial Tone Line rate increases in the past (*e.g.*, 730 percent between 1990 and 1994), subscription levels for Residence Basic services have been unaffected (Exh. VZ-2, at 10). Moreover, the rate changes permissible under the Plan are extremely small in comparison to those past changes. Individual comparisons between states establish nothing about the actual or potential impact of rate changes in Massachusetts. The most relevant data on this issue is the actual experience during and after the significant Dial Tone Line rate increases resulting from the Department's rate-rebalancing efforts between 1990 and 1994. *New England Telephone and Telegraph Company*, D.P.U. 89-300 (1990). According to the data, Massachusetts telephone penetration rates varied little from year to year either during or after those significant increases (Exh. VZ-2, at 10; Exh. AG-2, at 12).

F. The Attorney General's Recommendation That the Department Freeze Basic Residence Rates Pending a Traditional Cost-of-Service Study Is Without Merit.

The Attorney General contends that the Department should freeze all regulated residence retail rates until the Department has fully investigated a current fully allocated Cost of Service Study (Attorney General Initial Brief, at 29-30). His argument is without merit and would improperly have the Department apply traditional cost of service ratemaking in a competitive market environment. As noted above, in markets characterized by competition, the forces of demand and supply will determine the *efficient* level of price (Exh. VZ-6, at 27). The Attorney General's proposed freeze on all regulated residence retail rates pending a fully allocated cost of service study therefore reflects an anachronistic perspective on the proper regulation of a competitive market for Residence telephone service.

G. The Attorney General's Critique of the Service Quality Plan Is Without Merit.

The Attorney General attacks Verizon MA's position concerning the need for and nature of an appropriate Service Quality Plan on a forward-looking basis (Attorney General Initial Brief, at 30-34). The broad argument is that the Department should reject Verizon MA's proposal to eliminate a service quality plan, reject Verizon MA's current service quality plan as outdated, and open an investigation into setting rising quality standards and thresholds for Verizon MA's retail service (*id.*, at 30). The Attorney General's contentions are without merit and fail to recognize that: (i) given the competitive nature of the market, a Service Quality Plan is not only unnecessary, but if applied only to one carrier, is discriminatory and could distort the competitive process; (ii) the Service Quality Plan adopted by the Department in D.P.U. 94-50 was found to provide the proper indications of overall service quality to customers; and (iii) the record is clear and unrebutted that Verizon MA provides excellent service to its customers.

1. The Attorney General's Call To Open An Investigation Is Untimely and Unnecessary.

The Attorney General requests that the Department open a new investigation to analyze the last ten years of consumer complaint data and examine the possibility of adjusting performance thresholds each year to match rolling data (*id.*, at 33). This request is both untimely and unnecessary and should be rejected by the Department.

The Hearing Officer's August 1, 2002 Memorandum included, as part of the Track B portion of the case, an examination of Verizon MA's Service Quality Plan and an opportunity for the Attorney General (and others) to submit alternative plans for regulatory treatment of Verizon MA's residence services. Hearing Officer Memorandum, *DTE Proposed Procedural Schedule*, August 1, 2002. In fact, the Attorney General knew he would be given the opportunity to propose alternative plans for Residence services, including alternative service quality plans,

since the original *Phase I Order*, issued on May 8, 2002. The Attorney General expressly acknowledged his understanding that "Track B will review appropriate regulatory frameworks and service quality plans proposed by Verizon [MA] and others." *Comments of the Attorney General on the Proposed Procedural Schedule*, at n.1 (August 15, 2002). In compliance with the schedule, the Attorney General offered only limited testimony and cross-examination on the issue (Exh. AG-1, at 5).

Notably, the Attorney General presented no alternative service quality plans during Track B. In fact, his witness testified that the Service Quality Plan adopted in D.P.U. 94-50 should be maintained (Exh. DTE-AG 1-1). Only now, after all evidentiary hearings have been concluded and the record closed, does he suggest that the Department instead use a different forum – a new docket – to investigate and decide the same issues that should have been addressed in this case. Accordingly, the Attorney General's request is untimely and should be rejected.

2. The Metrics and Standards in Verizon MA's Service Quality Plan Are Appropriate, If a Service Quality Plan Is To Be Required.

The Attorney General states that the last time the Department set service standards for service quality was in 1995 (Attorney General Initial Brief, at 32). He argues that the current standards are outdated and in need of change in light of more recent developments in the telecommunications industry (*id.*, at 33). He also suggests that the Department consider for use in Massachusetts the different types of service quality "items and thresholds" used in other jurisdictions (*id.*, at 33-34). The Attorney General's suggestions miss the mark.

Although the telecommunications markets have indeed matured and evolved over the past few years, the fundamental needs and desires of customers have not changed. The performance measures included in Verizon MA's proposed plan were approved by the Department in 1995 because they were the best indicators of overall service to customers. That

was true in 1995, and is just as true today. Customers want services that are installed correctly when promised. The existing measures cover these parts of Verizon MA's operations in the Missed Installation Appointments and Installation Troubles measurements. Customers also want services that are reliable and that are fixed quickly when problems occur. Here too, the current measures address the service quality for these operations through the Network Trouble Report Rate and Troubles Cleared in 24 Hours metrics. When customers have questions or problems, they want easy access to their service provider. There are five service response metrics in the existing plan that measure Verizon MA's responsiveness (Exh. VZ-4, Attachment 2). The Attorney General presented no evidence in this case which establishes that there are better measures for assessing service quality.

Similarly, an examination of service quality plans in other jurisdictions is unnecessary as suggested by the Attorney General. The Department has concluded, at a time when there was significantly less competition and more need for a service quality plan, that the "items and thresholds" included in the D.P.U. 94-50 plan were adequate.[7] In short, if the Department were to include service measurements in the new alternative regulation plan, the existing plan already measures the key components of service quality (Tr. 2, at 145). Again, the Attorney General offered no evidence even remotely suggesting that additional measurements or plans from other states will better gauge service quality. Accordingly, the Department should reject his position.

[7] It is interesting to note that an examination of Exhibit DTE-VZ 1-8 shows that while Specific metrics vary from state to state, there is no area of service that remains uncovered in Massachusetts. For example, some states have an "Out of Service" metric while Massachusetts has a "Cleared in 24 Hours" metric; some states have a metric for "% of Calls to Directory Assistance Answered Within x Seconds" while Massachusetts has a metric for "Directory Assistance Average Speed of Answer." And, none of the service quality plans in other states includes the rolling standard mechanism suggested by the Attorney General.

III. AT&T'S AND WORLDCOM'S ARGUMENTS SEEKING TO IMPOSE CONDITIONS ON VERIZON MA'S PLAN AND FURTHER REDUCTIONS IN SWITCHED ACCESS RATES ARE WITHOUT MERIT AND SHOULD BE REJECTED BY THE DEPARTMENT.

AT&T states that the best way to ensure that retail rates are consistent with competitive pricing is to give Verizon MA the pricing flexibility it needs to recover an appropriate amount of joint and common costs from its retail customers (subject to a cap of 10 percent per year increases) (AT&T Initial Brief, at 1). AT&T conditions its position on: (1) continued CLEC access to UNE-P and fiber-fed loops; and (2) the establishment of appropriate price floors (*id.*, at 3).

WorldCom states that it does not oppose approval of Verizon MA's Plan, provided two modifications are adopted by the Department (WorldCom Initial Brief, at 1). First, Verizon MA should be required to further reduce its intrastate switched access rates to Total Element Long Run Incremental Cost ("TELRIC") over a three-year period. AT&T also makes this proposal but unlike WorldCom does not appear to make it a condition for Department approval of the Residence portion of Verizon MA's Plan. Second, WorldCom contends that Verizon MA's Plan should be subject to suspension if the level of Residence local competition in Massachusetts is frozen or reduced as a result of the elimination of the UNE Platform ("UNE-P") (*id.*).

AT&T and WorldCom's proposed conditions are premature and not necessary for Department approval of the Verizon MA Plan at this time.

A. The Department Should Not Impose Any Conditions On Adoption of Verizon MA's Plan.

The Department should reject AT&T's and WorldCom's claim that the Residence portion of Verizon MA's Plan should be conditioned on the continued availability of UNE-P. First, as the Department knows, the FCC is now addressing in its Triennial Review the unbundling obligations of incumbent Local Exchange Carriers ("ILECs"). *First Triennial Review of the*

Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, CC Docket No. 01-338; *see Notice of Proposed Rulemaking*, FCC 01-361 (rel. December 20, 2001). Although AT&T and WorldCom maintain that continued access to UNE-P is necessary for residential competition to be maintained, Verizon and other ILECs have shown at the FCC that CLECs are not impaired in providing switched services without the UNE-P combination. Whether the current set of UNEs comprising UNE-P meet the statutory standards for unbundling will be decided by the FCC sometime in 2003. It is both premature and inappropriate to place any condition on approval of Verizon MA's Plan before the FCC acts. Following adoption of the Plan, the Department will continue to have jurisdiction over Verizon MA, and if there are changes in FCC policies that affect the competitive market for telephone services in Massachusetts, the Department can take action based on specific facts.[8] In fact, the Department has already put in place a mechanism to monitor the marketplace by requiring that Verizon MA annually file a report on competitive activity in Massachusetts. *Phase I Order*, at 95 and n. 59. The Department has clearly adopted a sensible course for considering changes in the marketplace.

Second, AT&T's and WorldCom's claim that competition in the Residence market in Massachusetts is dependent on UNE-P is unsupported by any record evidence. Indeed, AT&T's lengthy discussion of the issue consists almost entirely of extra-record claims. What the record here does show is that UNE-P is not being used by CLECs in Massachusetts as the primary means for offering competing services. To the contrary, the data presented by Verizon MA in Phase I of the case establishes that the principal means by which CLECs are competing in the

[8] To the extent that the FCC concludes that access to the elements that comprise UNE-P is not necessary under the Act, Verizon MA would not expect the Department to contradict such a conclusion, particularly in a market as intensely competitive as is Massachusetts.

Residence market are resale, UNE loops, and their own facilities (RR-DTE-2A [Phase I]). In short, there is no factual basis for the Department to impose any condition based on the record in the case.

Finally, the limited pricing flexibility for Residence Basic services in Verizon MA's Plan is reasonable without reference to any particular level of competition. As the Department noted, the small annual increase permissible under the Plan gives Verizon MA the ability, should market conditions allow, to move rates closer to economically efficient levels. This has long been a Department objective, and the record here fully supports the limited flexibility. Verizon MA presented unrebutted evidence in this case demonstrating that the Residence Dial Tone Line rate is far below an economically efficient level because it fails, by a significant margin, to provide a comparable level of contribution toward the recovery of Verizon MA's joint and common costs as other services (Exh. VZ-5, Attachments A and B). Moreover, as Dr. Taylor explained, a 5 percent annual increase will essentially keep Residence Basic service at current levels in real terms (Exh. VZ-3, at 14-15). This limited flexibility hardly presents a situation where competitors or customers will be harmed if the FCC eliminates certain elements from the unbundling requirement under the 1996 Act.

Likewise, AT&T's claim that continued pricing flexibility should be conditioned on the availability of fiber-fed loops suffers from the same flaws as its position concerning UNE-P. Moreover, its claim that Verizon MA "has refused to provide an unbundled loop when the end user resides at the end of a fiber-fed loop, even when the only service requested by the end user is voice telephone" (AT&T Initial Brief, at 27-28) is not based on any record evidence and is factually incorrect. It is plain that AT&T's argument is merely a restatement of its position in D.T.E. 98-57, Phase III concerning access to broadband, packet switching services over fiber-fed

loops. The FCC has, however, already ruled that incumbent LECs have no obligation, except in limited circumstances, to unbundle advanced services. In its *UNE Remand Order*, at ¶ 306,[9] the FCC concluded that "given the nascent nature of the advanced services marketplace, we will not order unbundling of the packet switching functionality as a general matter." The FCC recognized: (i) there was significant competition for advanced services in the market; (ii) equipment needed to provide advanced services (such as DSLAMS and packet switches) are readily available on the open market; (iii) mandatory unbundling may retard investment and innovation by ILECs in new advanced services technologies; and (iv) regulatory action could "stifle competition in the advanced services market." *Id*., ¶¶ 307-308, 314-316. Consistent with these findings, the FCC declined to unbundle packet switching, except when certain specific conditions set forth in 47 CFR § 51.319(c) (3)(B) were satisfied.[10] Although the FCC is further considering the issue of unbundling broadband services in the Triennial Review, there is no basis for the Department to condition its adoption of Verizon MA's Plan on an unbundling

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9 *In the Matter of Implementation of the Local Competition Provisions of the Telecommunications Act of 1996 CC Docket No. 96-98, 15 FCC Rcd. 3696 (1999).*

10 Those conditions are:

> (i) The incumbent LEC has deployed digital loop carrier systems, including but not limited to, integrated digital loop carrier or universal digital loop carrier systems; or has deployed any other system in which fiber optic facilities replace copper facilities in the distribution section *(e.g.*, end office to remote terminal, pedestal or environmentally controlled vault);
>
> (ii) There are no spare copper loops capable of supporting the xDSL services the requesting carrier seeks to offer;
>
> (iii) The incumbent LEC has not permitted a requesting carrier to deploy a Digital Subscriber Line Access Multiplexer at the remote terminal, pedestal or environmentally controlled vault or other interconnection point, nor has the requesting carrier obtained a virtual collocation arrangement at these subloop interconnection points as defined by § 51.319(b); and
>
> (iv) The incumbent LEC has deployed packet switching capability for its own use.

requirement that does not exist today under current law and may not exist in the future. The Department should, therefore, reject AT&T's claim.

With respect to AT&T's recommendation that appropriate price floors for Verizon MA's Residence services be set to ensure the availability of competitive alternatives (AT&T Initial Brief, at 29), the Department has already addressed this issue. In the *Phase I Order*, the Department stated that it will undertake, after the Phase II filing, a further investigation of price floors for Residence services to ensure that Verizon MA's rates will not impede efficient competition. *Phase I Order*, at 103. The Department clearly intended for this investigation to take place after Verizon MA's Plan was in place, and there is no reason to defer implementing Verizon MA's Plan until that investigation in complete.

B. The Department Should Reject Claims for Further Reductions in Switched Access Charges.

In compliance with the *Phase I Order*, Verizon MA reduced its intrastate switched access rates to equal the currently lower interstate access rates. *Phase I Order*, at 63. AT&T and WorldCom argue that this measure is insufficient, and that Verizon MA should be required, instead, to reduce intrastate switched access rates further, *i.e.*, to TELRIC levels (AT&T Initial Brief, at 4-7; WorldCom Initial Brief, at 1). Their claim is clearly without merit and beyond the scope of this proceeding.

The purpose of Track B of this proceeding is to review Verizon MA's Plan for compliance with the directives and findings of the *Phase I Order*. *See* Hearing Officer Memorandum, *DTE Proposed Procedural Schedule*, August 1, 2002. Contrary to AT&T's and WorldCom's contention, the *Phase I Order* required only that Verizon MA reduce its intrastate switched access charges to the interstate levels. The Department specifically ordered that "intrastate switched access charges will be lowered to the more cost-based interstate levels."

Phase I Order, at 63. Nothing in the Department's order required any further reduction in switched access charges, and nothing suggested that the Department would consider further reductions in this case. Verizon MA's compliance with the Department's directive is beyond question. Indeed, no party presented any contrary evidence (Exh. VZ-1, at 4-5; Tab B). Nothing further is required at this time.

Moreover, contrary to AT&T's and WorldCom's claim, reductions in intrastate switched access charges are not necessary to promote competition in the toll market – it already is intensely competitive. Ms. Brown testified that the charges for switched access service have been reduced over time to reduce the historical levels of contribution, but there is no reason to move those charges to TELRIC rates as long as the competing toll prices contain the similar levels of contribution (Exh. VZ-5, at 6). She noted that the Department's price floor standards ensure that the contribution included in Verizon MA's toll rates is greater than or equal to the contribution included in Verizon MA's switched access rates (*id.*). Indeed, Dr. Taylor explained that the relevant measure of incremental cost can, and should, never be TELRIC, which is reserved under the FCC's rules to be a measure of incremental cost for an unbundled network element, not a service (Exh. VZ-6, at 32-33).

IV. CONCLUSION

The objections of the intervenors to Verizon MA's Plan are without merit and should be rejected by the Department. The record demonstrates that Verizon MA has complied fully with the Department's directive to implement a revenue-neutral adjustment to the Residence Dial Tone Line rate to account for reductions in Intrastate Switched Access prices and the elimination Touch Tone rates. As the record also demonstrates, providing Verizon MA with the ability to increase rates for Residence Basic services by a modest 5 percent annually furthers the

Department's goal of more market-based and efficient pricing of telecommunications services. Residence Basic service prices are well below efficient competitive levels, and such prices forestall competitive entry to the detriment of all consumers in Massachusetts. At the same time, Verizon MA's Plan furthers the goal of universal service by maintaining the rates for LifeLine customers at the existing levels so that customers who cannot afford service will see no increase in their rates. Verizon MA's Plan will result in just and reasonable rates, consistent with the policy objectives that the Department has traditionally used for assessing changes in regulatory requirements.

Respectfully submitted,

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